Blockchain technology enables the electronic transfer of ownership rights in gold securely and seamlessly between accounts in regulated financial houses. PHOTO:REUTERS

Gold often overlooked as form of collateral

Given the yellow metal's importance in the Asia-Pacific, its wider acceptance could make for a significant boost to the liquidity and soundness of the markets. BY STEVE WAGER

MOST Asia-Pacific banks have successfully implemented the safeguards mandated by the G-20 after the financial crisis, and are compliant with the new rules regarding financial solvency.

However, one consequence of the enactment of Basel III / Dodd Frank / Markets in Financial Instruments Directive regulations and other prudential and regulatory standards has been an increase in the cost of collateral assets mandated to support the higher capital charges for banks.

The rising cost of collateral assets limits the ability and capacity of banks to participate in financial markets, extend new credit and take on new financing obligations. Consequently, countries where major institutions are adhering to these new rules could experience a decrease in market liquidity and ultimately, growth. Additionally, the expected hike in US interest rates may have a negative impact on the cost of market financing in many countries.

The new global collateral asset

Gold bullion is often overlooked as a form of collateral and is allowed under many nations' capital rules. The metal holds three key benefits in that it is:

- Highly liquid across time zones;
- Extremely popular in Asia for trading, investing and saving;
- Accepted as a universal store of value.

Gold is acceptable as collateral under Basel III rules in many jurisdictions, including Singapore, Japan, China, Hong Kong, Indonesia, South Korea, Australia and the US. Thus, banks can trade and manage their risks with the assurance that capital requirements and margin accounts are backed with a relatively low-risk asset of real and measurable value.

There are natural reasons for Asian firms to utilise gold as collateral. Unlike many other parts of the world, such as the US, gold is a fundamental part of Asians' savings and investment portfolios. Although the demand for gold has tapered in China recently due to the economic slowdown, Asia continues to be a significant portion of the global gold market.

According to the World Gold Council's most recent statistics, during the second quarter of this year, Greater China, Japan, Indonesia, Malaysia, Singapore, South Korea, Thailand and Vietnam accounted for 79.2 tonnes, or 39 per cent, of global institutional bar and coin demand. Consumer demand during the same period in these countries stood at 292.6 tonnes, or 41 per cent, of global demand.

Asia is also a significant player on the supply side. According to the World Gold Council, Asia as a whole produced 22 per cent of the world's total newly-mined gold last year, with China accounting for around 15 per cent of total global production.

Singapore, as a major financial capital and one of Asia's leading centres for trading and post-trade processing, has much at stake in this issue. Its government has encouraged the development of an investment-grade trading and refining cluster for qualifying gold bullion and other precious metals.

Given the growth potential ofinvestment-grade precious metals internationally, Singapore Customs worked with other government agencies such as International Enterprise Singapore, Inland Revenue Authority of Singapore and Ministry of Finance to exempt investment metals from the Goods and Services Tax (GST) in October 2012. This aligns Singapore's tax approach with practices in other countries where gold is traded heavily, such as in Australia, the UK and Switzerland.

Given the yellow metal's importance in the Asia-Pacific, its wider acceptance could have a significant impact on the liquidity and soundness of the markets. Using gold as collateral frees up other assets so they can be put to work in other parts of the economy for the benefit of their owners.

With so much gold flowing through the system in Asia, and an expected increase in the need for collateral, now is the time for market participants to consider using gold as collateral.

> Exchanges and clearing houses that allow gold as collateral are in a unique position to unlock opportunities for clients, trading firms, banks and other key intermediaries. Many global exchanges and clearing houses, including CME Group and LCH Clearnet, accept gold as collateral.

Impact of blockchain technology

Exchanges and clearing houses that allow gold as collateral are in a unique position to unlock opportunities for clients, trading firms, banks and other key intermediaries. Many global exchanges and clearing houses, including CME Group and LCH Clearnet, accept gold as collateral.

In Asia, Singapore Exchange accepts gold bars and gold certificates from banks approved by the MAS as margin collateral. The Shanghai Gold Exchange also announced recently that it will begin allowing gold for margin accounts in order to "boost market services".

Should the use of gold for collateral increase as expected, there will be a new need to securely coordinate regional and global inventories and make ownership transfers more efficient. Blockchain technology can provide the infrastructure to safely, securely and instantly transfer tokens representing perfected ownership rights to gold bars between financial institutions. This would enable investors who are currently storing gold in the safety of Singapore vaults to maintain that gold in Singapore, yet utilise it for collateral needs across Europe and the Americas.

Trading firms large and small participate in markets on a 24-hour basis to capture opportunities around the world, including in Asia, whose markets can set the tone for the global trading day. Using innovative blockchain technology, gold collateralisation can be streamlined significantly for firms whose collateral would optimally follow the sun.

The "travelling" token

For example, a trader can begin the trading day using a gold token as collateral in Singapore or Shanghai. Once he has finished trading and flattened his positions, the token would then be transferred to become his collateral in London or Frankfurt. After flattening his positions in Europe, his firm can then finish the trading day using the same token as collateral in New York or Chicago. Because the token can be seen by the recipient firm as soon as it has been sent, the need to hold large margin balances at firms in different time zones is, for practical purposes, eliminated.

Many global banks are readily embracing the prospect of blockchain technology for a variety of purposes, including collateral management. itBit, leveraging its status as a New York state regulated trust company, is now able to digitise ownership rights in allocated gold bars in itBit-approved vaults, and electronically transfer ownership rights in those bars securely and seamlessly between accounts in regulated financial institutions. Banks, brokers, futures commission merchants, exchanges and clearing houses that are on itBit's network, called Bankchain, can digitally move those bars with the push of a button.

We look forward to more financial participants globally, particularly those in the Asia-Pacific, accepting and utilising their gold and encouraging their clients to use gold as collateral. We are encouraged by the increased adoption of blockchain technology around the world. The combination of a traditional financial instrument like gold bullion with sophisticated new blockchain technology can be beneficial for the safety, security and liquidity offinancial markets and, ultimately, for the strength of the global financial system.

THE BUSINESS TIMES
Singapore Press Holdings
News Centre, 1000 Toa Payoh North, Podium Level 3, Singapore 318994
SPH 6319-6319 | BT 6319-5360 | FAX: 6319-8278
Customer service: 6388-3838
www.businesstimes.com.sg
Press releases: btnews@sph.com.sg
Letters: btletter@sph.com.sg